

Submission on Exposure Draft Legislation

Improving Fairness and Integrity in the Tax System - Tightening the Non-Commercial Loan Rules in Division 7A of the Income Tax Assessment Act 1936

We have reviewed the exposure draft legislation and explanatory material and believe the legislation, as drafted, will result in some unintended consequences in relation to the “dwelling” concession. Because it is the main area of our interests and expertise, we have confined our review to the proposed amendments to section 109C.

1. The proposed section 109C(4)(3D) states:

(3D) Paragraph (3)(d) does not apply to a licence or other right to use a dwelling, if:

- (a) the entity carries on a business; and
- (b) the entity is or has been granted a lease, licence or other right to use:
 - (i) the land or water on which the dwelling is situated; or
 - (ii) land or water adjacent to the land or water on which the dwelling is situated; or
 - (iii) the building in which the dwelling is situated;for the primary purpose of carrying on that business; and
- (c) the licence or other right to use the dwelling was granted for the purpose of enabling the entity to utilise the lease, licence or other right mentioned in paragraph (b); and
- (d) the area of the dwelling is less than 10% of the area of the land, water or building mentioned in paragraph (b).

Note: For the meaning of **land**, see paragraph 22(1)(a) of the *Acts Interpretation Act 1901*.

Problem 1 ~ Occupier of farm house does not carry on the farming business

- 2. The concession in section 109C(4)(3D) will result in many farm families having to pay their family company rent for the use of the farm homestead as it requires the entity granted the licence to live in the house to carry on a business.
- 3. The occupiers of the farm house do not always carry on a business and will therefore not be able to obtain the benefit of the concession.
- 4. The problem is illustrated by the following examples:

Example 1

Farm Pty Ltd owns the farming property “Whiteacre” on which a house is situated. The house is less than 10% of the area.

The shareholders in Farm Pty Ltd are Bob and Sally.

Bob and Sally live in the house on “Whiteacre”.

The farming business on “Whiteacre” is conducted by Bobsall Pty Ltd as trustee of the Bobsall Family Trust.

The farming business can clearly take advantage of the concession in the proposed section 109C(4)(3C).

However, as the business is conducted by Bobsall Pty Ltd as trustee of the Bobsall Family Trust and not Bob and Sally, Bob and Sally can not take advantage of section 109(4)(3D).

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Example 2

Farm Pty Ltd owns the farming property "Whiteacre" on which two houses are situated. Each house is less than 10% of the area.

The shareholders in Farm Pty Ltd are Bill, Mary, Bob and Jenny.

Bill and Mary are Bob and Jenny's parents.

Bill and Mary live in one of the houses and Bob and his wife Sally live in the other house.

Bill and Mary used to operate a business on "Whiteacre", however, they are now retired but have chosen to stay living on the farm as long as they can.

The farming business on "Whiteacre" is conducted by Bobsall Pty Ltd as trustee of the Bobsall Family Trust.

As they are not carrying on a business, nor are they involved in one carried on "Whiteacre", Bill and Mary are not covered by the exemption in clause 109C(4)(3D).

Problem 2 ~ Land in a number of titles and the 10% limit is breached.

5. Under the proposed legislation Land is defined as including messuages, tenements and hereditaments, corporeal and incorporeal, of any tenure or description, and whatever may be the estate or interest therein.
6. It is unclear from this definition how the land owned by a family company would be looked at when there are multiple titles making up a farm.
7. Most rural properties are made up of a number of titles. We are concerned that while a dwelling may not take up 10% of the whole of the land licensed by a company it may take up more than 10% of one of the titles.
8. Our concern is set out in the following example:

Example 3

Farm Pty Ltd owns the farming property "Whiteacre" on which a house is situated.

"Whitacre" comprises 3 separate titles as follows:

Lot 1	1,000 acres
Lot 2	40 acres
Lot 3	200 acres

All 3 lots are licensed to Bobsall Pty Ltd as trustee of the Bobsall Family Trust to conduct its business.

Bob and Sally live in the house.

The house is situated on Lot 2 and the house and garden take up 5 acres (2 ha).

The dwelling comprises 12.5% of the area of Lot 2, but only 0.4% of the total area of "Whiteacre".

We are concerned that Bob and Sue may not be able to take advantage of the concession in section 109C(4)(3D) as it could be argued there are 3 licences and that the dwelling takes up more than 10% of one of the licensed Lots.

Problem 3 ~ A small portion of the farm owned by the family company but the garden is large so the 10% limit is breached.

9. It is common for rural properties to be owned by a combination of owners.
10. We are concerned that the land owned by a family company may be a small proportion of the farm but that due to the house having a large garden the 10% limit is breached.
11. Our concern is set out in the following example:

Example 4

“Whiteacre” is a 5,000 acre farm and is owned as follows:

Farm Pty Ltd	60 acres
Bob	2,500 acres
Bob and Sally	2,000 acres
Bobsall Family Trust	440 acres

The business on “Whiteacre” is operated by Bob and Sally in partnership.

The house on “Whiteacre” is on the land owned by Farm Pty Ltd.

Bob and Sally live in the house.

As space is not an issue for them Bob and Sally have a 10 acre garden around the house.

The house only represents 0.2% of the area of “Whiteacre”, however, it represents 16.67% of the land owned by Farm Pty Ltd. As a result Bob and Sally will not be able to take advantage of the concession in section 109(4)(3D).

Problem 4 ~ Large gardens

12. It is common for rural properties to have large gardens as the space is available.
13. The term dwelling only includes the actual house and not the surrounding garden.
14. The proposed section 109C(4)(3E) extends the dwelling to include the surrounding land used in conjunction with the dwelling. However there is a limit of 2 hectares (5 acres) in section 118-120.
15. Many farm gardens may exceed the 5 acre limit resulting in the concession being only partially available.

Problem 5 ~ Section 109(4)(3D)(c)

16. This provision states that “the licence or other right to use the dwelling was granted for the purpose of enabling the entity to utilise the lease, licence or other right mentioned in paragraph (b)”.

17. That is, the licence to use the dwelling must have been granted to enable the entity to use the land in its business.

18. Example 15 of the Explanatory Memorandum states:

“Due to the remote location of the farm, Aaron and Liz would not be able to utilise the farm to run their business without accommodation on the farm. In addition to the licence to use the farmland, Farm Pty Ltd therefore provides Aaron and Liz with the right to use a farmhouse that is situated on the farmland.”

19. In closer settled areas (and many not so closer settled areas) it could rarely be said that a farming family *“would not be able to utilise the farm to run their business without accommodation on the farm”* as indicated to be a condition of relief in the Explanatory Memorandum.

20. Our concern is shown by the following example.

Example 5

“Whiteacre” is a 5,000 acre farm owned by Farm Pty Ltd.

The farming and grazing business on “Whiteacre” is operated by Bob and Sally in partnership.

Bob and Sally live in a house on “Whiteacre”. While living on the property is a lifestyle choice for Bob and Sally and is convenient, the business is not reliant on them living in the house on the property.

“Whiteacre” is 10km from the nearest town which has a population of 6,000 and there are a number of houses available for rent in the town and on the surrounding farms.

As the use of the house by Bob and Sally is not essential to enable them to use their licence to use “Whiteacre” the concession provided by section 109C(4)(3D) would not be available.

Problem 6 ~ Unused cottages

21. With the decreasing population in rural areas and an increase in the number of farm employees living in nearby towns there are a number of vacant houses and cottages on farms owned by companies.

22. Will the new rules apply to them if they are not used in the business conducted on the land but are effectively licensed to the business operator along with the rest of the land owned by the company?

Problem 7 ~ Intensive industries

23. Some intensive industries can be operated from relatively small areas.

24. The 10% area limit could mean legitimate businesses are unable to take advantage of the concession in section 109C(4)(3D).

25. Our concern is shown by the following example:

Example 6

Charlie and Pam operate a hydroponic vegetable business on land owned by their company.

The total area of land owned by the company is 5 acres. Of this the house and yard take up 1 acre and the business is operated on 4 acres.

The business requires Charlie and Pam to live close by in case there is a problem with any of the pumps.

As the house takes up 20% of the area the concession in section 109C(4)(3D) will not be available in relation to the house area even though Charlie and Pam must live on the premises to operate their business.

Problem 8 ~ the ambiguity in proposed sub-section 109(4)(3D)

It isn't clear whether "land" In sub-section 109(4)(3D) means land used in a business or land owned by the relevant company.

26. The ambiguity is shown by the following example:

Example 7

"Whiteacre" is a 5,000 acre farm owned by Fred Smith and leased to Bob and Sally Brown. There is no family relationship between them.

The farming and grazing business on "Whiteacre" is operated by Bob and Sally in partnership.

Bob and Sally live in a house next door to "Whiteacre" which is owned by their family company Bobsall Pty Limited.

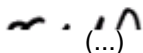
Bob and Sally would not be able to utilise "Whiteacre" to run their business without accommodation on the farm or very close to it.

If "land" in sub-section 109(4)(3D) means land used in Bob and Sally's business they are entitled to the concession. If on the other hand it means land owned by Bobsall Pty Limited they are not.

Thank you for your time.

Please contact me if you have any queries with the issues raised.

Yours faithfully
JMA Legal



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